

ability and allowing the sponsor to continue in operation on a more sound footing. In either case, a claim against the PBGC could be made. 3/

A final argument is that the costs of pension insurance are being paid by the wrong plans, and that the program is therefore inefficient from an economic point of view. According to this perspective, federal rules relating to the PBGC and to pension funding must be changed to reallocate the program's costs and to provide more appropriate incentives for sponsors and participants.

The Case for No Change. Analysts who advocate making little or no change in the pension insurance program support their view by noting the especially hard economic times recently experienced by firms in certain industries, the concentration of the dollar value of claims against the PBGC among a small number of plans, and the tremendous uncertainty about future claims.

The recent problems experienced by the pension insurance program can be viewed as the result of larger difficulties faced by some employers in so-called declining industries. In such cases, the PBGC might be seen as serving an appropriate and valuable function by aiding affected workers. Long-term declines experienced by some industries--which in turn are attributable to changes in consumer taste, production technologies, and the value of the dollar relative to other currencies, among other factors--have forced major changes in certain sectors of the economy and have adversely affected many workers. Support provided by the PBGC to some of the hardest-hit workers and firms can be interpreted as aid for dislocated workers--such as job training assistance and Trade Adjustment Assistance--and may be helpful in facilitating more rapid adjustment and recovery.

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3. Some analysts take this situation a bit farther, arguing that unless the program's current and future debts are reduced sufficiently, the pension insurance program one day may reach a point where all of its assets have been used to pay current benefits, and the program will run out of money. At this point, a likely course of action would be for the shortfall in the program to be made up through a combination of changes: premiums would be increased for existing plans, perhaps including a one-time added amount to inject funds into the program; benefit guarantees would be cut back, transferring some of the program's shortfall directly to the insured workers; and federal general revenue might be used to pay part of the agency's debt. The difficulty under this scenario is that many sponsors and participants would see this situation on the horizon, and--because of the voluntary nature of private pensions--would terminate their defined-benefit plans to avoid the added costs of insurance. This outcome would reduce significantly the future importance of defined-benefit plans as a vehicle for saving for retirement and would transfer more of the program's debt to the remaining pension plans--including any existing underfunded plans whose sponsors are prohibited by law from terminating them so long as the sponsor remains solvent--and eventually to federal taxpayers.

Similarly, to the extent that the PBGC's difficulties stem from the financial problems of a very few pension plans, its current difficulties may not represent a broader trend for the future. In this case, making significant changes in the pension insurance program at this time could be an overreaction: instead, action might be withheld unless it becomes clear that there is a wider trend toward terminating underfunded plans. Like the previous argument, this one treats the recent program experience as unusual and not likely to persist.

Finally, the tremendous uncertainty about future pension funding levels and the terminations of underfunded plans in itself suggests that changes might be delayed as long as possible. The pension insurance program has sufficient resources to make annuity payments to insured participants for several years, so there is no imminent need for added resources. Instead, or at least in the interim, those funds might be used more productively in the private sector.

#### What Types of Benefits Should be Insured?

The nature of the protection provided by the PBGC also is being questioned. One issue is whether the government should continue to insure pension benefits that have not been fully funded at least at some time in the past. This situation usually arises because certain pension costs are amortized over several years.

The basic argument for denying insurance protection for benefits that have never been funded is that insuring them goes well beyond the traditional protection provided by the government in other areas, such as in insuring bank deposits. In the case of the PBGC, insurance is provided not only against market-related fluctuations in the portfolios of pension plans--a normal aspect of insurance--but also against the inability of sponsors to provide sufficient future funding to meet their past pension promises. On the other hand, workers are unlikely to understand the fine points of pension insurance, and the government's own rules are often the source of underfunding.<sup>4</sup> These facts would argue for retaining the current definition of insured benefits.

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4. Current federal rules and accepted actuarial principles allow sponsors to spread their pension costs over many years, thereby raising the likelihood that the PBGC will be called on to pay for some of these benefits.

### Who Should Pay for Insurance Protection?

With recent growth in the cost of pension insurance--from \$1 per participant in the original legislation in 1974 to \$8.50 today--and with the prospect of considerably higher insurance premiums in the future, the issue of who should pay them becomes an increasingly important one.

The costs of pension insurance could be allocated in several ways. One way would be to continue distributing the costs equally among participants in all single-employer defined-benefit pension plans. This approach would spread program costs widely, but it would include many plans that have little likelihood of making a claim. In addition, because the insurance costs remain the same regardless of the plan's funding status, this approach provides no incentive for participants or sponsors to increase the funding of their plans.

Alternatively, insurance costs could be targeted toward plans that are more likely to make claims against the PBGC, as measured by their current financial status. This allocation would tie premium payments more closely to anticipated costs and would also provide an incentive for participants and sponsors to raise the funding levels of their plans. Better funding, in turn, might reduce the probability of insurance claims and would lower insurance premiums. But charging higher premiums to less well-funded plans could worsen their financial condition, thereby potentially making it more likely that those plans would be terminated and that claims would be made against the PBGC.

Finally, costs could be distributed more broadly, perhaps among all federal taxpayers. This method would insulate plans that continue in operation from any financial difficulties caused by plans that have terminated. It could be viewed as an inappropriate use of federal funds, however, because general taxpayers would be supporting a relatively small number of pension participants, many of whom have above-average wages.

### OPTIONS FOR REALLOCATING PROGRAM COSTS

Whether or not it is appropriate to make changes to reduce the financial shortfall in the pension insurance program, the program's costs may not now be appropriately allocated among plans. The main concern is that the premium paid on behalf of each participant is the same regardless of the insurance risk posed by his or her plan.

This flat-rate premium structure may result in an inequitable distribution of costs because sponsors of, and participants in, well-funded plans are required to subsidize the pension plans of financially weak sponsors with

underfunded plans. This situation is seen as unfair because it dictates that healthy plans pay for the inefficiencies or the bad luck of other firms--in some cases, the direct competitors of firms with healthy plans. Further, the subsidy now generated by the flat-rate premium structure arguably is one factor that helps some inefficient businesses stay in operation, thus leading to the misallocation of investment capital in the economy. <sup>4/</sup>

One response would be a variable-rate premium structure, in which the premium charged on behalf of pension participants would vary among plans according to the risk that the plan represents to the insurance program. This risk depends both on the size of the potential claim and on the probability that the claim will be made, with the former being much easier to estimate than the latter. A related view would require plans to obtain private insurance for their pension liabilities as a way to achieve fully risk-related premiums.

A variable-rate structure would provide an incentive for sponsors to raise the funding levels in their plans in order to reduce their insurance costs. It would also remove some of the subsidies inherent in the current structure, which in turn could make the economy somewhat more efficient.

On the other hand, charging potentially very high premiums for certain plans might cause their sponsors to go out of business. This result would be especially regrettable if a lower premium would have enabled the sponsor to weather its hard financial times and again become profitable. Premium assessments based on risk also would be subject to potentially large errors, because of the difficulty of predicting accurately the likelihood that particular pension plans will terminate.

#### Designing a Variable-Rate Premium Structure Determined by the PBGC

If a variable-rate premium structure was adopted, it would have to include a basis for assessing premiums and might also specify maximum or minimum premiums to be charged.

The Premium Base. A variable-rate structure would tie premiums to the potential financial losses that the plans represent to the insurance program. This result could be accomplished to various extents by linking the premium

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4. With premiums as low as \$1.00 or \$2.60 per participant, these inter-firm subsidies might be ignored, but with premiums of \$20 or more this might no longer be the case. See PBGC, "Variable-Rate Premium for the Pension Benefit Guaranty Corporation's Single-Employer Insurance Program" (Discussion Paper, October 1986).

to the level of unfunded benefits in the plan that are guaranteed by the PBGC (called the "exposure" of the PBGC related to a specific plan), to the probability that the plan will terminate with a claim against the PBGC, or to both. 5/

Basing the premium on the amount of unfunded guaranteed benefits in a plan would tie it to the level of the potential claim against the PBGC. Such an exposure-based structure would provide an incentive for sponsors and participants to reduce underfunding in their plans and, over time, could link the program's revenues to the level of underfunding in covered plans. Unfunded vested benefits--that is, the present value of vested benefits less the market value of the plan's assets--has been suggested as an approximation for exposure, because it is now routinely calculated by many plans.

Basing the premium on the probability that the plan will terminate would be more difficult. The PBGC has found, for example, that while it can identify groups of plans from which terminations often later arise, these groups also include large numbers of plans that do not terminate. Thus, basing insurance premiums on the expected probability that a plan will terminate could lead to large errors for some plans, thereby penalizing some of them and undercharging others. According to the PBGC's analysis, more reliable forecasting methods are needed before basing a large portion of variable-rate premiums on these probabilities. 6/

The Maximum Premium. Any premium based on exposure or risk might also include a maximum, or cap. While any particular limit on the annual premium would be arbitrary, it could be set equal to a given fraction of average annual pension costs for all sponsors or at specific dollar limits such as \$50 or \$100 per participant, with the latter possibly indexed over time.

Such a cap would help ensure that the cost of the premium itself would not lead to financial difficulties for the sponsor, or to termination of the plan, but it would also limit the extent to which insurance costs would be allocated according to risk or exposure. In addition, once a plan became sufficiently underfunded so that its premium reached the cap, the sponsor would have less incentive to avoid further reductions in funding.

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5. An equal premium would continue to be charged on behalf of all participants in a given plan under proposals made to date. In particular, the premium would not be based either on the level of pension benefits accrued by each participant or on the amount of those benefits that are unfunded. The main reason for this simplification presumably is that contributions to defined-benefit plans--and returns on pension assets--are not tied to the accounts of specific participants, so that allocations of funding generally could only be done on an average per-capita basis.
  6. See PBGC, "Variable-Rate Premium," Appendix I.

The Minimum Premium. A variable premium might also have a minimum rate greater than zero, which would limit the share of the program's costs that are actually variable. For example, only expected new claims might be allocated on a variable basis, with past shortfalls and administrative costs, which are independent of the current funding status of ongoing plans, being assigned equally to participants in all insured plans. In addition, having a minimum greater than zero would eliminate the difficult task of identifying plans that would pay a zero premium--namely, those that have essentially no risk of terminating with inadequate funding.

Some analysts maintain that all program costs should be subject to a variable premium, however, because all of the costs of the pension insurance program are based, either directly or indirectly, on the terminations of underfunded plans. Moreover, a fully variable premium would add to the incentive for sponsors to fund their plans.

Examples of a Variable-Rate Premium. The parameters of a variable-rate premium would depend on the required level of revenue and on the desired degree of variation in costs among plans. A simple structure, for example, might assess a premium of zero to participants in plans that are sufficiently funded on a termination basis, and increase that premium at a rate of, say, \$5 for each \$1,000 per participant that the plan is underfunded.<sup>7/</sup> In this case, a pension with 1,000 participants that was underfunded by \$2 million would be underfunded by an average amount of \$2,000 per participant; thus, the premium paid on behalf of each participant would be \$10.

Charges assessed on the basis of underfunding would only affect a minority of plans, however. As noted in Chapter IV, for example, in 1984 an estimated 17 percent of plans with more than 100 participants--and an approximately equivalent share of participants in those plans--were in plans that were underfunded.<sup>8/</sup> The estimated average premium generated in the above example in 1984 would have been roughly \$23 per participant in plans that paid an underfunding charge, but less than \$4 per participant when averaged over all covered participants.

Some proposals would provide a "cushion" on the definition of an underfunded plan by also assessing an underfunding charge on plans that were

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7. A charge based on underfunding *per participant* is considered in these examples because the current premium is assessed on a per-participant basis. Equivalent results could be obtained by charging the entire plan a premium that would vary according to its overall funding status.
  8. Recall that these calculations were made after adjusting reported liabilities to a common interest rate that approximated the one used by the PBGC in that year to value liabilities in terminated underfunded plans.

close to being underfunded. For example, plans might be assessed an underfunding charge of \$5 for each \$1,000 that they were less than 110 percent funded or less than 125 percent funded, on a per-participant basis. This would increase the revenue from the funding charge because it would expand the definition of underfunding and increase the share of plans that were assessed underfunding fees. Raising the threshold from 100 percent to 125 percent, for example, would have increased the shares of both plans and participants charged an underfunding fee in 1984 by about 13 percentage points. Under this scheme, the estimated average premium in 1984 would have been roughly \$29 per participant in plans that paid an underfunding charge, or a little more than \$8 per participant when averaged over all participants.

Maximum and minimum charges also could be added to the premium structure. An upper limit on the premium would affect only plans that otherwise would have to pay very large premiums. For example, if a maximum of \$50 per participant was placed on the premium in the first example, an estimated 1 percent to 2 percent of participants would have been in plans subject to this limit in 1984. Higher maximums, of course, would affect the plans of even smaller shares of participants. A minimum charge would affect all covered participants if it were made in addition to the variable charge, and would raise the average premium by almost the full amount of that new minimum.

The revenue in future years from most variable-rate premium structures would be highly uncertain. It would depend not only on the extent of funding of pensions generally, but on the distribution of funding among plans. Flat premiums, on the other hand, would have relatively certain revenue outcomes because they depend only on the future number of covered participants--a quantity that has grown rather slowly and steadily in the past.

#### Require Private Insurance for Pensions

Requiring sponsors to obtain private insurance for their plans would result in premiums being assigned in the private insurance market rather than by the government. Under this system, premiums would vary among plans according to the assessments of risk made by private insurers and would result in plans paying premiums based on the expected cost of benefit payments for the insurer. Moreover, because of the nature and timing of pension commitments, private insurance contracts probably would be more similar to "whole-life" life insurance policies than to "term" life insurance, and thus might extend over many years.

The role of the federal government under this system might be limited to two functions. First, the government could provide reinsurance for private insurers. Under this arrangement, the government would help finance claims against an insurer if several large plans that it insured were terminated nearly at the same time. To pay for this protection, the government could charge a premium to the private insurers. Second, the government might also provide insurance to plans that could not obtain private insurance at "reasonable" prices. For example, the government might agree to provide insurance for any plan at \$100 per participant. This feature would limit insurance costs paid by pension plans but would also leave the government with a substantial financial exposure, because the risk associated with these plans must exceed \$100 per participant or else the plans would purchase private insurance.

Proponents of this alternative maintain that private insurers would calculate premiums that more accurately reflect expected insurance payments than would the government, and that this would result in fewer subsidies among plans. Opponents contend there is little experience to date in the private market for this type of insurance, however, and that relatively little is known about it. Questions remain, for example, about what the overall average increase in insurance premiums would be compared with what the PBGC would require to be self-sufficient, and about the nature of the financial arrangements that would be made.

#### OPTIONS FOR REDUCING UNDERFUNDING OR THE TERMINATION OF UNDERFUNDED PLANS

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Insurance of private pension benefits can, by its very nature, increase the likelihood that pensions will be underfunded and that underfunded plans will be terminated. As discussed earlier, insurance protection reduces the cost of terminating an underfunded plan both to the sponsor and to the participants, thereby reducing their incentive to avoid that event. Given the goal of the pension insurance program to promote income security of covered participants, however, this moral hazard is to some extent a necessary side effect of insurance protection.

Recent changes in federal laws limit these side effects somewhat. Changing the insured event from termination of an underfunded pension to financial distress of the plan's sponsor limits the conditions under which terminations can occur. Increasing the maximum liability of the sponsor for unfunded pension benefits reduces the incentive of the sponsor to terminate its pension, especially if the sponsor anticipates continuing in business. Finally, providing the Internal Revenue Service with explicit authority to



require security on waivers of minimum pension contributions may limit underfunding in some plans operated by weak sponsors, but it could also make the termination of certain plans more likely to occur.

Nonetheless, some incentives remain to underfund pensions and to terminate those plans that are underfunded. To further limit these incentives, other changes could include:

- o Increasing minimum annual pension contributions by sponsors;
- o Further restricting waivers of minimum funding standards; and
- o Reducing insurance protection for certain benefits derived from layoffs or plant closings.

#### Increase Minimum Annual Pension Contributions by Sponsors

The financial status of pension plans could be improved directly by increasing the required minimum annual pension contributions by sponsors. Changes could be made to tie pension contributions to the termination-based funding levels of the plans, or to reduce amortization periods for certain pension costs.

Require Annual Pension Contributions to Depend in Part on Termination-Based Funding. Larger pension contributions by sponsors of underfunded plans could be mandated by tying contributions directly to the termination-based level of funding in the plan or to expected pension outlays in the near future. Pension contributions are now determined by actuarial funding methods that generally distribute pension costs to current and future years based on the assumption that the plan will continue in operation.

Under these changes, sponsors also would consider explicitly the funding status of their plans as if they were to terminate today, and would more fully fund benefits that already are owed to participants. For example, sponsors of underfunded plans could be required in each year to make up a specified share of unfunded liabilities. They also might be required to tie contributions to current benefit payments and to those expected in the next few years, to ensure that the funding of the plan did not deteriorate. This approach also would link funding more closely to the maturity of the plan's work force.

These changes would not necessarily add to sponsors' total pension expenses, but would move payments forward in time. Moreover, these op-

tions could result in the explicit realization by the sponsor and by participants that their plan would not be fully funded if it were to terminate suddenly, and progress toward full funding might be enhanced once this fact was realized. On the other hand, current funding methods for pensions are based on accepted accounting and actuarial principles that are thought by many to be sound. This view is supported by the fact that only a very small share of pensions that terminate contain any unfunded liabilities.

Reduce Amortization Periods for Certain Pension Costs. Alternatively, or in conjunction with the above changes in minimum contributions, sponsors could be required to speed up the funding of certain pension costs that they are now allowed to spread over several years. For example, gains or losses based on the experience of the plan, such as those attributable to incorrect predictions of economic conditions and the behavior of workers, currently can be amortized over 15 years, and the cost of ad hoc benefit increases generally can be spread over 30 years. Faster amortization of these pension costs could raise the funding level of plans in the intervening years, and could reduce the exposure of the PBGC. It also might encourage more prudent future adjustments in benefits in some plans. On the other hand, these accelerated contributions in many cases may not be needed to pay benefits for several years. In the interim, requiring accelerated amortization might reduce the flexibility of sponsors and participants by raising required contributions.

#### Further Restrict Waivers of Minimum Funding Standards

Although the Internal Revenue Service now is authorized to require security on waivers of minimum funding standards, further statutory restrictions on the availability of waivers have been proposed. Suggestions include further limiting the conditions under which waivers are allowed to cases where business hardship affects the entire group of employers associated with the plan, and to cases in which the hardship is only temporary; reducing the allowable number of waivers, which is currently 5 in 15 years; and restricting the amortization period for repaying waived contributions from 15 years to a shorter period of time, perhaps determined by the plan's funding level.

Further limiting waivers could increase the funding levels in some plans, but might worsen the financial position of the sponsor and make more likely the future termination of the plan. Unfortunately, few data are available on either the dollar amounts of past waivers or on the pre- and post-waiver financial status of the sponsors who received them.

One reason to restrict waivers further is that they represent loans by potentially poorly funded plans to sponsors who are in weak financial condi-

tion--loans that might not be considered good investments. Healthy sponsors generally are not allowed to borrow from their pension plans, even though such loans might be better investments. On the other hand, recent changes allowing the IRS to require security on waivers may be adequate protection for limiting potential abuses of this feature of pension finance. If so, continuing the current waiver policy would allow sponsors in financial difficulty a chance to regain profitability, instead of prematurely terminating either their pension plans or their overall business operations.

#### Reduce Insurance Protection for Certain Benefits Derived from Layoffs or Plant Closings

Reducing insurance protection for extra pension benefits derived solely from layoffs or plant closings could result in less reliance on this type of benefit in future pension agreements, and might lead to reduced underfunding of some plans.<sup>9/</sup> According to provisions in some plans, additional benefits such as increased early retirement payments are available to workers if they are laid off or if their plant is shut down.

The cost of these added benefits can lead to financial problems both for the sponsor and for the PBGC. If the sponsor is forced by business conditions to lay off large numbers of workers, then the added liability for these benefits can, in itself, lead to financial difficulties. Although sizable portions of these benefits are not insured, they also can lead to higher claims against the PBGC, either because a portion of them is insured or because they are paid to participants--in lump sums, for example--before the plan is terminated, thereby reducing the funds that remain later to pay benefits that are guaranteed. The PBGC estimates that in the steel industry alone, roughly \$1 billion in unfunded claims have resulted from this type of benefit, although few other data exist on the inclusion of these benefits in pension agreements.

Removing insurance protection for these benefits might place the sponsor, the plan, and the PBGC at less risk if the sponsor needed to react to changes in business conditions. In addition, if these benefits remained available but were not insured, participants might be less willing to accept the termination of their pension plan as a consequence of the sponsor's financial difficulties.

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9. Instead, the payment of these benefits could be made conditional on funds being available, perhaps in a separate account that would not be used to meet minimum funding standards. Alternatively, separate insurance could be provided for these benefits.

On the other hand, this option might lower the income security of workers who lose their jobs, which in turn might make them less willing to accept economic change, thereby potentially reducing the adaptability of the economy. Moreover, changing this aspect of pension policy might be premature because funding problems resulting from this provision have yet to be documented.

#### OPTIONS FOR RAISING PROGRAM REVENUE OR REDUCING OUTLAYS

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Several features that directly improve the program's financial status also could be changed. Options include raising the insurance premium charged on behalf of insured participants, increasing receipts from other sources, and reducing outlays for benefits by making either across-the-board or other, more selective reductions in benefit guarantees.

##### Increase the Insurance Premium

Program revenue could be increased directly by raising the insurance premium charged on behalf of participants. This could be done by increasing that premium by a certain amount or by indexing it to changes in a relevant indicator.<sup>10/</sup> A one-time increase in the premium could result in a larger immediate rise in program revenue--and in insurance costs for sponsors--than would instituting an indexed premium that generated the same revenue during a given time period. The desired increase in revenue would depend on how quickly the accumulated program deficit was to be repaid, and on expected future claims.

Raising revenue by increasing the premium would help to restore solvency to the program by using the mechanism originally designed to provide program funds. On the other hand, large increases in premiums could discourage the future use of defined-benefit pensions, with a possible reduction in the income security of affected workers.

Increase the Premium by a Certain Amount. A one-time increase in the premium could be achieved either by raising the current flat-rate premium or by charging a premium with variable rates, the average of which matched the higher flat rate. Raising the flat-rate premium would affect all covered

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10. Federal law requires a concurrent resolution of both Houses of the Congress to change the insurance premium, although changes to date have been made through legislation passed by the Congress and signed by the President.

sponsors, while charging a premium that varied according to the funding status of the plan might affect only a minority of them. In either case, each \$1 increase in the average premium in 1988 would generate just over \$30 million in revenue in that year.

Index the Premium. In addition, or as an alternative, to a jump in the premium, the premium could be indexed to future values of an indicator such as the Social Security wage base.<sup>11/</sup> This method of indexation currently is used to adjust the upper limit on guaranteed pension benefits and could be applied to the premium as well. Indexing the premium to wages would ensure that its value relative to a major determinant of pension amounts remained constant over time, but receipts would not fluctuate with the financial needs of the PBGC.

Alternatively, the premium could be tied directly to the level of claims against the PBGC. For example, the average premium in a given year could be related to claims against the PBGC during the preceding one-year or five-year period. This structure would allow for automatic adjustments in revenue in response to changes in the needs of the program, although it could result in very high premiums if the financial condition of the PBGC were to worsen further.<sup>12/</sup>

#### Increase Other Program Receipts

Revenue also could be increased by imposing a one-time charge on behalf of pension participants, raising the priority of PBGC's claim on the assets of sponsors of terminated underfunded plans in bankruptcy proceedings, or using federal general revenue to pay part of the debts of the PBGC.

Impose a One-Time Charge on Pension Participants. In addition to increasing the insurance premium, revenue also could be raised from sponsors by imposing a one-time charge on behalf of participants. This could be done, for example, by assessing for all current participants a fee based on the per-capita amount of the accumulated program deficit, or by assessing a one-time charge only for participants who leave the pension system or who are in plans that terminate. As noted earlier, a charge of about \$120 for each current participant would be sufficient to fund the accumulated program deficit of \$3.8 billion. Larger charges would be needed if they were only paid by some sponsors.

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11. Changes in the Social Security wage base are determined annually by changes in the level of wages of covered workers.

12. See PBGC, "Variable-Rate Premium," Appendix III.

Assessing charges only for participants who leave the system, or only for those who are in plans that terminate, would reduce the short-term impact of this option on revenue. Imposing a charge on behalf of all participants who leave the insurance system eventually would yield revenue equal to and then in excess of that generated by a one-time charge on behalf of all current participants. Restricting the charge to sponsors of plans that terminate would generate a smaller amount of revenue than either of the other two options if the per-participant fees were the same, but would not raise pension costs for participants in plans that continued in operation.

Imposing a one-time charge on behalf of covered participants would continue to rely on insured plans as the source of program funding. On the other hand, concentrating this charge in one payment could be a financial burden for some sponsors, especially if it were assessed on behalf of all covered participants.

Raise the Level of the PBGC's Claim in Bankruptcy Court. The ability of the PBGC to recover assets from sponsors of terminated underfunded plans could be enhanced if the priority of the agency's claim in bankruptcy court were raised. The part of the PBGC's claim that does not exceed 30 percent of the sponsor's net worth currently has the priority status of a federal tax lien. The remainder of the claim normally has unsecured general creditor status and is subject to mandatory extended payment terms. Recoveries on employer liability claims, including claims for unpaid contributions, have averaged about eight cents on the dollar, according to the PBGC.

A sponsor's pension obligations might be given higher priority in bankruptcy settlements if workers have accepted lower cash wages in the past in return for these promises. On the other hand, any additional assets recovered by the PBGC would come at the expense of other creditors, thereby shifting the pension cost to parties that were not involved in promising to pay them.

Use Federal General Revenue to Fund the PBGC's Debts. Federal general revenue also could be made available to fund part of the claims against the pension insurance agency. Under current law, the PBGC can borrow up to \$100 million from the federal Treasury but, beyond that commitment, the federal government is not directly involved in paying program costs. As mentioned earlier, some of the aid provided by the PBGC is similar to federal spending to help dislocated workers and, to that extent, might be a candidate for using federal general funds. On the other hand, because pensions are voluntary and affect only a relatively small share of the population, direct federal involvement would mean that general taxpayers were subsidizing voluntary private-sector projects. Instead, the program's costs might be paid by those who benefit from the insurance protection.

### Reduce Outlays for Benefits

Reducing benefits for new claimants also would improve the financial situation of the PBGC. Outlays could be reduced by lowering insurance protection across the board, by lowering the maximum benefit guarantee, or by restricting insurance coverage for particular kinds of benefits.

Reduce the Level of Insurance Protection. Insurance protection could be reduced in an across-the-board fashion by lowering future guarantees to some fraction of their current level, such as to 85 percent of the current guarantee. This change would proportionally reduce benefit payments to all future recipients and could limit future outlays significantly. Using past claims as an indicator of future ones, for example, reducing the present guarantee rate on benefits from 100 percent to 85 percent might lower the present value of future insurance claims by roughly \$50 million to \$100 million annually. On the other hand, this option could be seen as abandoning a previous promise made by the federal government. It also could reduce benefits received in future years by some relatively poor retirees for whom such a change could mean a significant reduction in their standard of living.

Lower Maximum Benefit Guarantees. Alternatively, outlays for benefits could be reduced by lowering the upper limit on monthly benefits guaranteed by the PBGC. The cap of \$1,858 per month in 1987, or about \$22,300 annually, presumably affects only a small share of beneficiaries, although data are not available on the impact of this limitation.

This change would only affect beneficiaries with the highest levels of income, thereby avoiding a major disadvantage of an across-the-board cut. In addition, this cap relates only to pension benefits and does not include Social Security or other sources of retirement income. On the other hand, because the cap is in nominal dollars and affects all future benefit payments for plans terminating in 1987, the real value of the limit actually is much lower. While pension income of \$22,300 may seem sizable today, the purchasing power of that income level will be much smaller in future years when many of the benefits actually will be paid.

Restrict Insurance Coverage. Program outlays also could be reduced by more selectively restricting insurance coverage. An example of this change was given earlier, involving benefits accruing solely because workers were laid off or their plants shut down. Other restrictions in coverage might also be considered if certain types of benefits were found to be important sources of underfunding and were concentrated in plans that terminated with claims against the PBGC. An advantage of this approach is that it might be used to influence the future availability of certain types of pension benefits, thereby achieving other federal policy objectives. On the other hand, reducing outlays in this manner could result in relatively large reductions in benefits for some workers, while leaving many others unaffected.

